ONTARIO ENERGY CORPORATION

Annual Report 1985

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PRESIDENT'S REPORT

Shareholder decisions in 1985 had a profound effect on the Corporation's level of activity and future role.

Early in the year, the Shareholder, the Minister of Energy, advised the Corporation that it should honour its investment commitments but make no new investments. In addition, the Shareholder confirmed that the Government was suspending its 1983 commitment to fund Ontario Energy Corporation (OEC) through equity purchases at a level of $23 million per year for five years. As a result, on April 1, the Shareholder subscribed for only $13 million of the $23 million equity commitment for 1985.

A review of OEC was subsequently initiated by the Government, which was to lead to a Policy and Priorities Board decision in June as to the future of the Corporation. Before that review could be completed, however, the Government changed and Mr. John Kruger was appointed as Special Advisor to the Premier, responsible for making recommendations as to the future of a number of Crown corporations, including OEC.

Since August 1985, an intensive evaluation of OEC's portfolio of investments has taken place, along with a review of Ontario's energy policy. The Government decided, as a result of new policy priorities, that OEC's assets should be disposed of in a prudent manner and that the employment of the Corporation's staff will be terminated by September 30, 1986. After that date, the management of any residual OEC investments will be the responsibility of the Shareholder.

A number of write-downs in investments were taken at year end (primarily a write-down of the purchase price discrepancy relating to the Suncor investment of $58 million and a $19 million write-down of the Polar Gas Project) and a $17 million charge to income for the Suncor equity adjustment resulted in the Corporation showing a deficit in retained earnings of $59 million. For 1985, the Corporation reported income from operations of $1.6 million before write-downs and equity adjustments compared to $0.5 million in 1984. A net loss of $102 million was recorded in 1985 after write-downs and equity adjustments compared to net income of $12 million in 1984.

At the end of 1985, the Corporation had 21 investments, all of which were with private sector partners. Of these, 14 were energy technology investments, while seven involved energy resource development. Consistent with the Shareholder's direction, no new investments were made in 1985.

As a result of the Corporation's changing circumstances, a number of measures were taken during the year to reduce corporate overheads, including a reduction in staff from 18 to 10.

ENERGY RESOURCES

The Corporation's subsidiary, Onexco Oil & Gas Ltd., through its joint ventures, had a highly successful year, participating in 81 oil and gas wells, of which 43 were completed as discoveries.

As well, Trillium Exploration Corporation continued its active exploration program in the frontier, participating in 25 wells with 16 (or 64 per cent) successful in discovering significant quantities of hydrocarbons.

Production income from the Corporation's resource investments through Onexco was $4.9 million, up $4.4 million from 1984.

In addition, the Corporation's investment in the James Bay Lowlands exploration project was written off due to the uncertain future economic environment for lignite development in Ontario.

ENERGY TECHNOLOGY

As part of a policy to rationalize its investment program, the Corporation's venture capital subsidiary, Ontario Energy Ventures Limited (OEV), sold its interest in two ventures to its private sector partners and recovered its investment with interest in a third venture.

As well, given the limited prospects for future profitability, OEV wrote down the carrying value of five other investments for a total write-down of $3.9 million.

SUNCOR

The performance of Suncor Inc. in 1985 was very disappointing. Overall, the company had a net loss of $10 million after a write-down of $56 million which was primarily related to Suncor management's view of the current value of its frontier assets.

CHANGES TO THE BOARD

During the year, the Shareholder appointed Mr. Ivan X. de Souza to the Board of Directors to replace Mr. David Melnik. The Board wishes to thank Mr. Melnik for his valuable contribution over the last five years.

In addition, the Board wishes to acknowledge and thank the Corporation's staff for their very high professional standards and dedication.

Respectfully submitted on behalf of the Board:

Malcolm Rowan.

Malcolm Rowan,
President and Chief Executive Officer

BOARD OF DIRECTORS

David L. Campbell**
President
David L. Campbell Ltd., Consultant

Ivan X. de Souza
President
Investcan Financial Corporation

Pierre Genest, Q.C.*
Senior Partner
Cassels, Brock & Blackwell, Barristers and Solicitors

George C. Hitchman**
Corporate Director

W. Edwin Jarmain*
President
Jarmain Communications Inc.

M. Theresa McLeod**
Director and Vice President
Merrill Lynch Canada Inc.

Gerald E. Nori, Q.C.
Partner
Wishart, Noble, Barristers and Solicitors

Malcolm Rowan*
President and Chief Executive Officer
Ontario Energy Corporation

* Also a Director of Suncor Inc.
** Audit Committee Member

OFFICERS

W. Edwin Jarmain
Chairman

Malcolm Rowan
President and Chief Executive Officer

K. Wayne Brush
Vice President

Glen C. Francis
Treasurer

Robert Law, Q.C.
Corporate Counsel and Secretary

Chung H. Yue
Assistant Secretary

AUDITORS

Deloitte Haskins & Sells

ENERGY RESOURCES

ONEXCO OIL & GAS LTD.

Onexco Oil & Gas Ltd. was very active in 1985, participating in 81 exploratory and development wells in Ontario and western Canada and, mainly through Trillium Exploration Corporation, in 25 wells in Canada's frontier regions. This was a 60 per cent increase in drilling activity over 1984.

Oil production averaged 360 barrels per day for the year, a significant increase over average 1984 production of 35 barrels per day. Production for December averaged 528 barrels per day, which includes the effect of a two-week shut-in of 273 barrels per day due to pipeline capacity in Alberta. Natural gas production averaged 239,700 cubic feet per day, up from 100,000 cubic feet per day in 1984. Production in December was 500,000 cubic feet per day.

Production income for 1985 was $4.9 million, a significant increase over 1984's $0.5 million. Capital investments (including Trillium) before Petroleum Incentives Program (PIP) grants during 1985 amounted to $61.7 million , up 5.5 per cent from 1984. Expenditures were financed by internally generated cash flow, PIP grants and loans from Ontario Energy Corporation.

At year end, Onexco's net land holdings amounted to 11.2 million acres, including the company's 66.67 per cent interest in Trillium's net land position.

Independent engineering evaluations of Onexco's conventional proven and probable reserves, as of December 31, 1985, show 1.3 million barrels of oil and 4.9 billion cubic feet of natural gas. An engineering evaluation of Trillium Exploration Corporation's reserves indicates Onexco's share of discovered reserves at 24 million barrels of oil and 364 billion cubic feet of natural gas, with an additional 486 million barrels of oil considered as potential reserves.

Frontier Regions

Trillium Exploration Corporation

Trillium was formed in 1982 by Onexco Oil & Gas Ltd. (66.67 per cent) and Suncor Inc. (33.33 per cent) to explore Canada's frontier regions. During 1985, Trillium participated in 25 exploratory and delineation wells with 16 discoveries. Since 1982, Trillium has participated in 46 wells, with 23 considered to be discoveries. Trillium has an interest in 47 million acres (7.2 million acres net) located in the major frontier areas.

Through this successful exploration and delineation program, Trillium is well positioned to take advantage of the significant potential in the future development of frontier reserves. In anticipation of the phase-out of PIP, Trillium's strategy in 1985 was to focus drilling expenditures on delineation of reserves which could be developed in a reasonable time frame. Current priorities are as follows:

1. Three potential development projects in the Beaufort Sea/Mackenzie Delta, one project off Newfoundland and one off Nova Scotia where production could commence in 1990 - 1995.

2. Several potential projects where reserves have been discovered and production could start in the 1995 - 2005 period.

3. Twelve prospects to be drilled in 1986 which, if successful, could have production in the 1990's.

4. Fifty-one defined prospects which could be drilled in the future.

5. Residual, unexplored lands of 2.5 million acres net.

The chart below lists Trillium's oil and gas discoveries since 1982.

Trillium Exploration Corporation Discovery Wells 1982 - 1985

Area	Trillium's Working Interest (Per Cent)	Well Operator	Test Results (Maximum Flow Rates) Oil	Gas
Beaufort Sea/Mackenzie Delta				
Adgo H-29	18.00	Esso/Home	837 b/d	21.6 Mmcf/d
Adgo G-24	18.00	Esso/Home	-	20.2 Mmcf/d
Amerk O-09	2.57	Esso/Home	-	18.0 Mmcf/d
Kadluk O-07	3.00	Esso/Home	-	14.5 Mmcf/d
Niptork L-19	2.57	Esso/Home	3,400 b/d	2.9 Mmcf/d
Niptork L-19A	2.57	Esso/Home	3,390 b/d	2.7 Mmcf/d
Tuk G-39	2.53	Esso/Home	Testing	
Tuk B-40	2.53	Esso/Home	Testing	
Tuk-Tuk A-12	2.64	Esso/Home	Testing	
Tuk M-09	2.64	Esso/Home	924 b/d	17.5 Mmcf/d
Tuk J-29	2.52	Esso/Home	1,035 b/d	6.9 Mmcf/d
Tuk H-30	2.52	Esso/Home	Testing	
Offshore Newfoundland				
Brothuk M-05	5.00	Canterra	1,632 b/d	-
Terra Nova K-08	5.00	Petro-Canada	5,200 b/d	4.0 Mmcf/d
Terra Nova K-07	5.00	Petro-Canada	4,125 b/d	3.2 Mmcf/d
Terra Nova I-97	1.25	Petro-Canada	Testing	
Offshore Nova Scotia				
Alma F-67	4.00	Shell	373 b/d*	29.9 Mmcf/d
Alma K-85	4.60	Shell	369 b/d*	30.0 Mmcf/d
Uniacke G-72	3.00	Shell	167 b/d*	20.6 Mmcf/d
Arctic Islands				
Cape Allison C-47	6.40	Panarctic	2,570 b/d	26.4 Mmcf/d
Cape McMillan 2K-15	3.00	Panarctic	975 b/d	22.7 Mmcf/d
East Drake L-06	3.70	Panarctic	-	25.0 Mmcf/d
Skybattle M-11	3.00	Panarctic	-	1.1 Mmcf/d

* Condensate.

Hudson Bay

During the summer and fall of 1985, Onexco participated, with eight companies, in two exploratory wells in Hudson Bay. This was the first exploration in the region since three wells were drilled in the early 1970's. Beluga O-23, in which Onexco had an 18.125 per cent working interest, commenced drilling in July and, while it encountered hydrocarbons, the reservoir was considered to be poor quality. Netsiq N-01, with Onexco having a five per cent working interest, started drilling in September and did not have any indication of hydrocarbons. At year end, the joint venture group was proceeding with land relinquishment as required under the regulations governing federal exploration agreements. Onexco's land holdings in Hudson Bay after relinquishment will be 6.3 million acres (net).

The Corporation's investment in Hudson Bay was written off at year end as there was no longer reasonable assurance that its investment would be fully recovered.

Conventional Regions

Western Canada

Onexco continued its successful western Canada joint ventures with Triweb Resources Ltd. and Mannville Oil and Gas Ltd. during 1985. In total, 65 exploratory and development wells were drilled, with 34 completed as oil discoveries and five as natural gas discoveries.

Production to Onexco's account from the two joint ventures averaged 288 barrels of oil per day and 239,700 cubic feet of natural gas per day. Year-end production was 402 barrels of oil per day (with 273 barrels per day shut-in for two weeks) and 500,000 cubic feet of natural gas.

Onexco's gross land holdings at year end in Alberta, British Columbia and Saskatchewan amounted to 190,900 acres (61,600 acres net).

Ontario

Onexco has two joint ventures in Ontario. One is operated by the Consumers' Gas Company and also involves Pembina Resources Ltd. The second is operated by Canadian Occidental Petroleum Ltd. with Petro-Canada as a partner.

During 1985, the Consumers' Gas joint venture drilled 16 wells, nine of which were commercially successful. The Canadian Occidental/Petro-Canada joint venture did not undertake any exploratory drilling in 1985.

Onexco's share of production from the Ontario properties averaged 72 barrels of oil per day over the year. Production in the month of December averaged 126 barrels of oil per day.

Gross land holdings for the two joint ventures are 156,000 acres, with Onexco's net acreage being 51,400 acres.

ONTARIO ENERGY RESOURCES LTD. (OERL)

Ontario Energy Resources Ltd. is a wholly owned subsidiary of the Corporation which retains the Ontario Government's 25 per cent equity interest in Suncor Inc.

In previous years, the difference between the cost of the Suncor shares to the Corporation and the underlying net book value of Suncor Inc., which related primarily to oil and gas reserves, was being amortized using the unit-of-production method. Due to today's unstable and lower crude oil prices, the Corporation believes it is no longer appropriate to continue amortizing this difference and, accordingly, it has been written off.

In December 1985, OERL prepaid the Note held by Sun Note Corporation (Sun) at a cost of $315 million. The Note was issued in 1981 to finance one-half of the $650 million Suncor purchase price. The note repayment fully discharged the Province's and OERL's obligations to Sun. Funds to prepay the Note were provided by the Province of Ontario and were accounted for as government assistance in the Corporation's financial statements.

Suncor's financial performance was severely eroded in 1985 due to lower sales of synthetic crude oil, lower synthetic oil prices, higher interest expense and an unusual charge against income of $56 million. The unusual charge included a $44 million write-down of frontier assets occasioned by carrying values no longer reflecting market realities, and a $12 million special charge to provide for costs associated with a two-year program to improve efficiency and productivity through employee reduction. Suncor's earnings for 1985 were $46 million before the unusual items, down from $118 million (restated) in 1984. Inclusion of these unusual charges produced a $10 million loss on the year.

Earnings in refining and marketing operations were higher in 1985 than in 1984, primarily due to the benefits from the Sarnia refinery hydrocracker complex. However, upstream operations had reduced earnings year-to-year due to a planned maintenance shut-down and a number of operating problems at the oil sands plant, lower synthetic crude oil selling prices and lower earned depletion.

ONEXCO MINERALS LTD.

Onexco Minerals Ltd. is a wholly owned subsidiary involved in lignite exploration in Ontario. The company holds a Licence of Occupation on 150,000 acres in the James Bay lowlands region of northeastern Ontario. While the company was an active, successful explorer over the 1980 - 1983 period, economic conditions caused field activity to cease in 1984; and this moratorium continued during 1985. At year end, an evaluation of the company's future activities was in process and all capitalized exploration costs were written off.

ENERGY TECHNOLOGY

ONTARIO ENERGY VENTURES LIMITED

During 1985, at the direction of its Shareholder, OEV made no new investments. Rather, OEV concentrated on rationalizing its existing portfolio and working with the management of its investments.

As part of its portfolio rationalization, OEV sold two of its 17 investments back to its private sector partners and recovered its investment with interest in a third venture.

By the end of 1985, OEV had also entered into discussions respecting the divestment or liquidation of a number of its remaining investments. These discussions are continuing into the new year, with the expectation that OEV's investment portfolio will be significantly reduced during 1986.

Portfolio Rationalization

Energreen

Energreen is a profitable greenhouse operation near Ramore in northern Ontario. The two-acre greenhouse is heated by hot exhaust gases from a nearby TransCanada PipeLines natural gas pumping station, allowing the operation to grow tree seedlings year round for reforestation activities, and vegetables for a local market.

OEV acquired 50 per cent of Energreen in 1982. OEV's investment allowed Energreen to grow into a prosperous business, employing 12 full-time staff and providing part-time employment for up to 50 local residents during the planting season.

In September 1985, OEV sold its interest in Energreen to its private sector partners who assumed full control of the company.

Endwaste

In a joint venture with Tricil Limited, OEV formed Endwaste in 1984 to investigate new energy from waste plants which support the recycling, re-use and recovery of solid waste in October.

After the joint venture had completed its market survey and investigation of potential sites, the joint venture partners agreed that the market conditions did not warrant a separate venture to pursue the limited number of projects available, and that Endwaste's future activities should be carried on solely by Tricil. Accordingly, OEV sold its interest in Endwaste to Tricil in April 1985.

Ontario Van Pool Organization (OVPO)

OVPO was established in 1980 to demonstrate the concept of third-party van pooling. During the five-year demonstration, OVPO showed that third-party van pooling can be a commercial enterprise, with the revenue from passenger fares being sufficient to recover the capital and operating costs of a van pooling operation.

Upon completion of the demonstration in 1985, 80 per cent of the vans (28) were sold to members of existing pools who wished to continue enjoying the advantages van pooling offers as a commuting option. The remaining vans were sold at public auction. The revenue from the sale of assets was sufficient to repay OEV's debt with interest and provide a dividend to OVPO's Shareholder, the Minister of Energy.

Current Portfolio

The investments held within OEV's portfolio, most of which are in their start-up phase, can be placed in one of the five areas of investment emphasis:

- energy from waste,
- energy management,
- enhanced oil recovery technology,
- substitution, and
- transportation.

Energy from Waste (EFW)

Over the past few years, OEC has dedicated a major effort to promoting new approaches to waste management, complementing the initiatives of the Ontario Ministries of Energy and the Evnrionment.

More specifically, OEV's current EFW investments are:

Hamilton Garbage Electric Generator

A joint venture with Tricil Limited, OEV invested in a steam-driven turbo-electrical generator at the Solid Waste Reduction Unit (SWARU) facility in Hamilton.

The turbine is designed to produce 14 million kilowatt hours of electricity annually from the burning of about 400 tons of garbage daily, enough to heat 620 to 875 homes in the Hamilton area.

Subsequent to year end, OEV came to an agreement with Tricil to sell it the Corporation's interest in the joint venture.

Omnifuel

Omnifuel, a joint venture of OEV, Canertech and Omnifuel Gasification Systems Ltd., engineers complex systems using fluidized bed gasifiers to produce alternate fuels from forest and agricultural residues and municipal waste.

Energy Management

OEV has five energy conservation-oriented investments. These include:

Petrosave

Petrosave Inc. is one of Ontario's leading supplier of Thermal Management Service (TMS), having contracts with the municipalities of Mississauga, Oshawa and Barrie. Under a TMS agreement, Petrosave for a fee:

- assumes responsibility for providing a building's energy requirements;
- provides the capital for and supervises the installation of new energy-conserving equipment and modifications;
- maintains the equipment that has been installed; and
- pays all energy utility bills on behalf of the building's owner.

G.K. Fleming & Associates

Fleming designs and installs computer software. In 1984, development work began on an Energy Conservation and Management System. The system was demonstrated in a large northern Ontario intgrated pulp and paper mill in 1985, and is now ready for the marketplace. The energy savings expected with this system are considerable, having application in a wide variety of other industries.

Bishop Fibretek

Bishop is developing and marketing a new type of fibre - Biswool. Biswool has various energy-related uses, such as improved insulation for homes, refractory bricks for industrial furnaces, reinforcement in plastics used in cars and reinforcement in concrete as well as a replacement for asbestos.

Bishop also produces and markets conventional mineral wool fibre, made out of the waste slag of iron foundries, for use in insulation, ceiling tiles, and fire-proofing.

Eneroil Research

Eneroil Research Limited is a product development company, specializing in energy-conserving products, such as high-efficiency domestic heating equipment using oil and gas.

Eneroil Sales

Eneroil Sales Inc. markets energy-conserving equipment developed by Eneroil Research. The current product line consists of a mid-efficiency oil furnace and a condensing unit which can be retrofitted to existing home oil furnaces to dramatically increase their efficiency by up to 40 per cent.

In 1985, OEV reduced its common equity holdings in Eneroil Sales by selling half of the common shares it held to Agway Petroleum Corporation, a major U.S. company. As part of the transaction, Agway injected additional preferred equity capital into Eneroil Sales, established and funded a U.S. marketing company for Eneroil Sales' product line and immediately ordered $1 million worth of product from Eneroil Sales.

Enhanced Oil Recovery

OEV has one investment in chemically enhanced oil recovery technology - an innovative method of unlocking oil from the ground.

Amerigo Technology

Amerigo Technology Limited is a Canadian chemical research and development company specializing in enhanced oil recovery. Its products are applicable to both conventional and heavy oil reserves.

During 1985, a pilot project in the Dodsland area of Saskatchewan, aimed at demonstrating the effectiveness of Amerigo's technology, came on stream. Results are expected in 1986 provided the economics of the project are not severely affected by the current softening in the price of crude oil.

Oil Substitution OEV has two oil substitution investments. These are:

Deltx Windpump — In association with Alberta Ventures Fund Limited and Abax Energy Services Ltd., OEV invested in Deltx Windpump Corporation to assist this company to commercialize a new type of wind-powered water pump.

Polar Gas — Since 1975, OEC has participated, as an agent of the Ontario Government, with TransCanada PipeLines Ltd. (the project manager), Panarctic Oils Ltd., Tenneco Energy Ltd. and Petro-Canada in the Polar Gas Project.

The project, when complete, will connect frontier natural gas supplies for future use by Canadians and will generate significant industrial benefits for Canada and Ontario during the construction phase. The estimated capital cost of the 1,333-mile (2 150-kilometre), 36-inch (92-centimetre) diameter pipeline is $3.2 billion (1984 dollars). It is expected that 90 per cent ($2.9 billion) of the investment will be spent on Canadian goods and services. A significant share of these expenditures will be made in Ontario.

In June 1984, Polar Gas filed applications with the National Energy Board (NEB) and the Department of Indian Affairs and Northern Development to build a natural gas pipeline from the Mackenzie Delta area to a point near Edson, Alberta. While it had been anticipated that regulatory reviews would be undertaken during 1985, market conditions and the NEB hearing schedule predicated a deferral until 1986.

As directed by the Shareholder, the Minister of Energy, OEC's financial participation in the Polar Gas Project will not continue beyond the first quarter of 1986.

Transportation OEV has three transportation investments. These are:

Teleride/Sage — Both Teleride Corporation and Sage Transportation Management Systems Limited design and install computer software for the public transit industry. The objective of their systems is to increase and improve transit ridership, which benefits the transit company as well as conserves energy.

Selachii International — Selachii International Limited has developed and is testing an alternative to conventional carburation for internal combustion engines. The Selachii Controlled Pressure Induction (CPI) fuel delivery system has the potential to reduce fuel consumption by four to eight per cent while significantly increase engine performance. The CPI can also be used with various alternative fuels, including gas/alcohol mixtures. The target market for the Selachii CPI is motorcycles and all terrain vehicles.

Other

Bio-hol

Bio-hol Developments is a joint venture between OEV and Weston Energy Resources Ltd. The joint venture has created a world-class biotechnology pilot plant research facility and has demonstrated the production of ethanol from wood residues using microbiological fermentation techniques. Ethanol can be used as a gasoline/alcohol mixture and could reduce Ontairo's need for crude oil.

1986 OUTLOOK

As a result of the Shareholder's decision to terminate the activities of OEC and its subsidiaries in 1986, at least in their present form, OEV will continue to rationalize its investment portfolio in the coming year.

This rationalization process will include divesting those investments which are mature enough to be sold, while continuing to work with the managements of a number of investments which are still in the early stage of development.

FINANCIAL STATEMENTS

PREPARATION AND REVIEW OF THE FINANCIAL STATEMENTS

The financial statements have been prepared by management in accordance with generally accepted accounting principles. Management is also responsible for the other information in the annual report, which is consistent with that contained in the financial statements.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board exercises its responsibilities through an Audit Committee of the Board, which is composed of directors who are not employees of the Corporation. The Audit Committee meets with management and the external auditors at least twice each year to satisfy itself that management's responsibilities are being properly discharged and to review annually the financial statements.

The external auditors, Deloitte Haskins & Sells, conduct an independent examination, in accordance with generally accepted auditing standards, and express their opinion on the Corporation's financial statements. The auditors' examination includes a review and evaluation of the Corporation's system of internal control. Appropriate tests and other procedures are conducted to provide reasonable assurance that the financial statements are presented fairly. The external auditors have full and free access to the Audit Committee of the Board. The Provincial Auditor has access and reviews from time to time the working paper files of the external auditors.

AUDITORS' REPORT

TO THE SHAREHOLDER OF ONTARIO ENERGY CORPORATION

We have examined the consolidated balance sheet of Ontario Energy Corporation as at December 31, 1985 and the consolidated statements of loss and deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1985 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Deloitte Haskins + Sells

Auditors
April 2, 1986

CONSOLIDATED STATEMENT OF LOSS AND DEFICIT
Year ended December 31, 1985

	1985	1984 (restated)
	(000's)	
REVENUE		
Interest	$ 1,451	$ 2,279
Production	4,944	529
	6,395	2,808
EXPENSES		
Production, operating and royalties	1,249	249
General and administrative	1,724	1,663
Depreciation, depletion and amortization	1,795	360
	4,768	2,272
INCOME FROM OPERATIONS	1,627	536
WRITE-DOWN OF INVESTMENTS (Notes 2 and 3)	(85,695)	-
EQUITY ADJUSTMENT IN INVESTMENTS	(17,580)	11,090
(LOSS) NET INCOME	(101,648)	11,626
RETAINED EARNINGS, BEGINNING OF YEAR - as previously reported	53,288	40,187
SUNCOR INC. ADJUSTMENT (Note 4)	(10,975)	(9,500)
(DEFICIT) RETAINED EARNINGS, END OF YEAR	$(59,335)	$ 42,313

CONSOLIDATED BALANCE SHEET
December 31, 1985

Assets		
CURRENT ASSETS		
Cash, short-term deposits and accrued interest	$ 5,425	$ 5,034
Accounts receivable	4,350	1,561
	9,775	6,595
INVESTMENTS (Note 5)		
Suncor Inc.	288,750	639,695
Trillium Exploration Corporation	47,390	39,135
Energy resource ventures	20,968	14,066
Energy technology ventures	4,265	7,700
Polar Gas Project	-	18,337
	361,373	718,933
FIXED ASSETS	39	134
	$371,187	$725,662
Liabilities		
CURRENT LIABILITIES		
Accounts payable and accrued charges	$ 257	$ 228
Short-term borrowings	7,550	-
Current portion of long-term debt	-	16,250
	7,807	16,478
LONG-TERM DEBT (Note 7)	-	585,000
	7,807	601,478
CONTINGENCY (Note 9)		
Shareholder's Equity		
SHARE CAPITAL (Note 8)	97,715	81,871
CONTRIBUTED SURPLUS (Note 7)	325,000	-
(DEFICIT) RETAINED EARNINGS	(59,335)	42,313
	363,380	124,184
	$371,187	$725,662

Approved by the Board:

Malcolm Rowan, Director

George C. Hitchman, Director

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

Year ended December 31, 1985

	1985	1984 (restated)
	(000's)	
SOURCES OF WORKING CAPITAL		
Operations		
(Loss) Net income	$(101,648)	$ 11,626
Items not affecting working capital		
Depletion	1,719	186
Amortization - Suncor Inc.	14,380	17,810
Other	96	174
Equity in earnings of investments	3,200	(28,900)
Write down of investments	85,695	-
Suncor Inc. dividends	10,449	10,449
Other dividends	-	20
	13,891	11,365
Government assistance	265,465	-
Issue of common shares	15,844	27,665
Loan repayment	-	278
	295,200	39,308
USES OF WORKING CAPITAL		
Reduction in long-term debt	260,000	16,250
Trillium Exploration Corporation	8,255	20,581
Energy resource ventures	12,876	6,521
Energy technology ventures	1,297	4,858
Polar Gas Project	921	757
Additions to fixed assets	-	26
	283,349	48,993
INCREASE (DECREASE) IN WORKING CAPITAL	11,851	(9,685)
WORKING CAPITAL DEFICIENCY, BEGINNING OF YEAR	(9,883)	(198)
WORKING CAPITAL (DEFICIENCY), END OF YEAR	$ 1,968	$ (9,883)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 1985

1. **Significant Accounting Policies**

Ontario Energy Corporation invests in, or otherwise participates in, energy projects with a view to enhancing the availability of energy in Ontario. The Corporation's involvement in its investments is in a financing rather than an operating role.

Basis of financial statement presentation

The consolidated financial statements include the accounts of Ontario Energy Corporation and its subsidiaries except Trillium Exploration Corporation ("Trillium"). Trillium is actively involved in an exploration program for oil and gas and its operations are not of a financial nature. Accordingly, Trillium is accounted for using the equity method because consolidating the accounts would not be more informative. Summary information describing the financial position and activities of Trillium is included in Note 5 to these financial statements. Other investments are also accounted for using the equity method.

The full-cost method of accounting is used to account for the Corporation's investments in oil and gas exploration activities whereby all costs of exploring for and developing oil and gas reserves are capitalized.

Oil and gas properties, categorized as energy resource ventures, are carried at the lower of capitalized cost, less accumulated depletion, and net recoverable value. Net recoverable value is the aggregate of future net revenues from proven reserves, determined using current prices and current costs plus the fair value of unproved properties.

Fixed assets

Furniture, equipment and leasehold improvements are stated at cost less accumulated depreciation and amortization. Depreciation is determined using the straight-line method over a period of 60 months; leasehold improvements are amortized over the terms of the leases.

Income taxes

The Corporation and its wholly-owned direct subsidiaries and their wholly-owned direct subsidiaries are not subject to income tax so long as not less than 90 per cent of the outstanding shares of the Corporation are held directly by the Province of Ontario. All of the Corporation's outstanding shares are presently held by the Province of Ontario. Onexco Oil & Gas Ltd., which is a wholly-owned indirect subsidiary of the Corporation, is subject to income taxes.

2. **Ongoing Operations**

As a result of a review of the Corporation's investments in the light of the province's current energy policy, the Province of Ontario has announced the following objectives for the Corporation's investments:

Suncor Inc.
To dispose of the Corporation's 25 per cent interest in Suncor Inc. when financially prudent.

Trillium Exploration Corporation and energy resource ventures
To dispose of OEC's direct investments in the oil and gas industry in a manner and at a time which will maximize the return on these investments. No further activities in the James Bay Lowlands will be conducted by OEC.

Polar Gas Project
To cease financial participation in Polar Gas beyond the end of the first quarter of 1986.

Energy technology ventures
Each investment will be examined individually and will either be retained or disposed of as appropriate.

It is uncertain at this time as to the outcome of the results of these activities and the effect they will have on the Corporation's ongoing operations.

3. **Write-down of Investments**

In previous years, the difference between the cost of the Suncor shares to the Corporation and the underlying net book value of Suncor Inc., which related primarily to oil and gas reserves, was being amortized using the unit-of-production method. Due to today's unstable and lower crude oil prices, the Corporation believes it is no longer appropriate to continue amortizing this difference and, accordingly, it has been written off.

Due to decisions by the Shareholder and other economic factors, the Corporation has written down the carrying value of certain other investments. These write-downs are summarized below:

	(000's)
Suncor Inc.	$ 58,151
Polar Gas Project	19,257
Energy resource ventures	4,379
Energy technology ventures	3,908
	$ 85,695

4. **Suncor Inc. Adjustment**

The Corporation's opening retained earnings for 1984 and 1985 have been restated to give effect to a change in accounting policy adopted by Suncor Inc. In accordance with the accounting recommendation issued by the Canadian Institute of Chartered Accountants, Suncor has adopted the cost reduction method of accounting for investment tax credits, effective January 1, 1985. Previously, Suncor had followed the flow-through method.

This change has been applied on a retroactive basis. Suncor's retained earnings at January 1, 1985 were reduced by $43.9 million. The Corporation's 25 per cent interest in Suncor's restated earnings was reflected by reducing 1985 opening retained earnings by $10,975,000, of which $1,475,000 relates to the 1984 income statement. The remainder, $9,500,000, is applicable to years prior to January 1, 1984 and the balance of retained earnings at that date has been adjusted accordingly.

5. **Investments**

Suncor Inc.

The Corporation owns 25 per cent of the issued common shares of Suncor Inc. which is accounted for using the equity method.

Summarized financial information of Suncor Inc. as at December 31 is as follows:

	1985	1984 (restated)
FINANCIAL INFORMATION	(millions)	
Working capital	$ 75	$ 122
Total assets	$2,390	$2,309
Shareholders' equity		
Preferred shares	$ 9	$ 9
Common shares and retained earnings	1,155	1,208
	$1,164	$1,217
Operations		
Revenue	$1,474	$1,584
Net (loss) income	$ (10)	$ 118
Dividends on common shares	$ 42	$ 42

Trillium Explorartion Corporation

The Corporation has a two-thirds interest in Trillium which was formed to explore for oil and gas in the frontier areas of Canada; Suncor Inc., which is owned 25 per cent by the Corporation, owns the other one-third.

The following is a summary of Trillium's financial position as at December 31:

	1985	1984
	(000's)	
Assets		
Current assets	$33,422	$38,486
Investment in Panarctic Oils Ltd. at cost	2,100	800
Property, equipment and exploration expenditures	39,128	27,298
	$74,650	$66,584
Liabilities		
Accounts payable and accrued liabilities	$ 3,717	$ 8,006
Shareholder advances		
Suncor Inc.	23,542	19,442
Ontario Energy Corporation	47,390	39,135
	74,649	66,583
Shareholders' equity	1	1
	$74,650	$66,584

Trillium has had no income or loss from operations and, because of its mandate to explore in the frontier areas, no income or loss is expected for a number of years.

Trillium is eligible for maximum Petroleum Incentives Program ("PIP") grants of 80 per cent of expenditures for the exploration for oil and gas in the frontier areas of Canada.

The Corporation has outstanding commitments to Trillium of approximately $31 million. These commitments will be reduced by PIP grants of approximately $25 million.

Polar Gas Project

The Corporation, as an agent of the Ontario Government, is one of five continuing participants in the Polar Gas Project, four of whom, including the Corporation, are presently funding the Project. The purpose of Polar Gas is to determine the feasibility of constructing and operating facilities for the transmission of natural gas from areas in the Canadian Arctic to southern markets.

The Corporation is committed to fund its share of the Project's program for the first quarter of 1986. At the direction of its Shareholder, the Corporation will limit its new funding in 1986 to a maximum of $250,000. Thereafter the Corporation will not continue to fund the Project. The Corporation's interest in the Project was written down to one dollar in 1985.

The Polar Gas participation agreement provides that, in the event a company is formed to build and operate transmission facilities, the Corporation's interest would be convertible into equity or debt of such company. Alternatively, under certain circumstances, the Corporation's investment may be repaid.

Energy resource ventures

The Corporation is involved in a number of oil and gas exploration and development ventures on provincial lands and in the frontier (Hudson Bay). Substantially all of these activities are conducted on a joint venture basis. At year end, the Corporation wrote off its investment in the Hudson Bay Joint Venture as there was no longer reasonable assurance that its investment would be fully recovered.

The Corporation has outstanding commitments of approximately $6.8 million. The funding of these commitments will be reduced by PIP grants to be received by the Corporation. The Corporation is eligible for maximum PIP grants of 80 per cent of expenditures for the exploration for oil and gas in the frontier areas of Canada and 35 per cent for exploration on provincial lands.

Energy technology ventures

The Corporation has invested in energy technology ventures of various types, many of which are in the development stage. These investments are typically in the form of a minority equity interest or debt.

Outstanding commitments to investees amount to $0.7 million.

6. **Government Assistance**

The Corporation received government assistance which is applied to reduce certain costs as follows:

	1985	1984
	(000's)	
For principal repayment of note due to Sun Note Corporation	$265,465	$ -
Interest expense on note due to Sun Note Corporation	$ 64,804	$ 41,304
Other investments	$ -	$ 3,199

7. **Long-term Debt**

The note due to Sun Note Corporation was prepaid on December 2, 1985 by the Corporation in the amount of $315 million, of which $47 million related to accrued interest. Of the $268 million principal amount, $2.6 million was provided by the Corporation. The balance of $265.4 million, provided by the Province of Ontario as government assistance to the Corporation, was applied to repay the principal outstanding on the note and reduced the carrying value of the Suncor investment. Additional interest of $17.8 million on the Sun note was incurred during the year and recovered by way of assistance from the Government of Ontario.

The non-interest-bearing demand loan due to the Treasurer of Ontario was forgiven by the Treasurer during the year and was accordingly treated as contributed surplus on the Corporation's balance sheet.

8. **Share Capital**

	1985	1984
	(000's)	
Share capital		
An unlimited number of common shares		
20,000,000 non-voting special shares		
Issued		
2,000,000 common shares	$100,000	$100,000
Less		
45,708 (1984 - 362,578) common shares held in Treasury, at cost	(2,285)	(18,129)
	$ 97,715	$ 81,871

During 1985, 316,870 shares held in Treasury were sold for cash of $15,843,500 including 260,000 shares for $13,000,000 sold pursuant to a five-year agreement signed in 1983 in which the Corporation's Shareholder agreed to purchase out of appropriated funds $23 million of equity in the Corporation for each of the years 1983 - 1987 inclusive. Further funding under this agreement is not expected.

9. **Contingent Liability**

a) One of the Corporation's subsidiaries is contingently liable as guarantor of one joint venture's performance bond guarantees up to a maximum of approximately $1.8 million.

b) In January 1985, the Alberta Court of Queen's Bench found in favour of Suncor Inc. in its dispute over the amount of sub-lease royalties payable to Norcen International Ltd. As Norcen has appealed the decision, neither Suncor nor the Corporation has recognized its financial impact, estimated to be $30 million after tax to Suncor prior to December 31, 1984, with interest thereafter. Should the issue be resolved in favour of Norcen, additional charges to Suncor's earnings to December 31, 1985 would be approximately $12 million. The Corporation's proportionate share of this contingent liability approximates $3 million. Upon final resolution of this issue, the financial impact will be reflected retroactively in the periods affected.

c) On October 30, 1985, Dome Petroleum Limited, Sulpetro Limited and CNG Producing Company instituted an action against Suncor Inc. regarding their obligation to pay an overriding royalty to Suncor on production from certain oil sands leases. The amount of disputed royalty revenues recorded by Suncor to December 31, 1985 is approximately $20 million before taxes. The Corporation's proportionate share of this contingent liability approximates $5 million. Any material adverse financial impact on the Corporation resulting from this action will be applied retroactively in the periods affected.

10. Subsequent Event

Subsequent to the year end, crude oil prices have declined significantly. The Corporation believes that, while it is currently inappropriate to consider that current price levels will prevail in the long term, should they do so, a substantial write down in the carrying value of the Corporation's oil and gas investments may be required.

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